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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

No. 731.

ROY BARTELS, ED BARTELS, CARL BARTELS AND JUSTIN CONLON, d/b/a CRYSTAL BALLROOM, PETITIONERS,

v.

E. H. BIRMINGHAM, INDIVIDUALLY AND AS COLLECTOR OF INTERNAL REVENUE FOR THE STATE OF IOWA, RESPONDENT

AND

GRIFF WILLIAMS, BILL CARLSEN, TINY HILL, BOYD RAEBURN, BUDDY FISHER AND PAUL MOORHEAD, INTERVENERS, RESPONDENTS

No. 732.

LARRY V. GEER AND MARGARET GEER, d/b/a LARRY GEER BALLROOMS, PETITIONERS

v.

E. H. BIRMINGHAM, INDIVIDUALLY AND AS COLLECTOR OF INTERNAL REVENUE FOR THE STATE OF IOWA, RESPONDENT

PETITIONERS' REPLY BRIEF.

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PETITIONERS' REPLY BRIEF.

STATEMENT AS TO CONFLICTING POSITIONS OF GOVERNMENT-RESPONDENT AND INTERVENER-RESPONDENTS.

The Intervener-Respondents' contentions are in violent conflict with the position taken by the Government-Respondent on the basic question of the correctness of the

holding below to the effect that the Form B contract, in and of itself, conclusively established an employer-employee relationship between the ballrooms and the sidemen and precluded consideration of other record facts proving a relationship different from that ostensibly created by the contract. In no uncertain terms the Government-Respondent's brief repudiates the "(lower) court's view of the conclusive nature of the contract" (p. 14) while practically all of Intervener-Respondents' brief is devoted to efforts to defend that holding.

Because of this situation this brief will deal first with the sole point of disagreement between petitioners and the government, namely, the question whether or not the Commissioner's determination on the disputed question of fact as to who was the employer is conclusively binding on the courts. The later pages will then reply to Intervener-Respondents' arguments which ask a holding of this court which the government brief candidly states would "permit circumvention of legislative enactments through mere skill in drafting legal papers which bear little or no relationship to the actual management of the affairs they purport to describe."

SUMMARY OF ARGUMENT.

I.

No finality or incontestability attached to the Commissioner's erroneous decision on the ultimate fact question of existence of employment relationship.

II.

Reply to Interveners' Brief.

A.

Correction of erroneous assumptions of interveners as to issue presented and as to certain facts.

1.

The basic question in these cases is not whether the leaders could become the employees of the petitioners but whether under all of the facts of this record the leaders were the employees of petitioners.

2.

The record facts abundantly sustain the trial court's finding that the parties to the Form B contract never intended that it would operate to transfer right of control from the leaders to petitioners.

B.

The rule that a written contract is not conclusive in determining the relationship of the parties is not confined to cases where the contract does not expressly vest the right of control in one of the parties.

C.

The decisions holding that a contract is not conclusive of a relationship are not based on a finding that the parties by their conduct either abrogated or abandoned the contract or substituted a new agreement.

D.

The so-called rulings of the Commissioner on fragmentary facts and on account of ex parte conferences with interveners' representatives did not purge the Form B contract of its character as "an anticipatory arrangement" to escape taxes.

E.

The rule that a taxpayer may lawfully change his status to avoid taxation has no application to the present cases wherein the undisputed record shows that the conduct of the parties, following the advent of the Form B contract, remained unchanged.

F.

The Form B contract itself expresses a primary intention that, in the event of a conflict between the by-laws of the American Federation of Musicians incorporated therein and its other provisions, the by-laws shall be controlling.

G.

Interveners' contention that the parol evidence rule applies to the present cases is not sustained by the authorities.

H.

Independent contractors are not employees within the meaning of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

I.

The record evidence persuasively indicates that if the fictions of the Form B contract were to be considered determinative the task of administering the social security laws would be rendered more difficult rather than simplified.

ARGUMENT.

I.

No finality or incontestability attaches to the Commissioner's erroneous decision on the ultimate fact question of existence of employment relationship.

The Government-Respondent brief makes clear that it *insists* that the government *not* be bound by any rule which would preclude the Commissioner from considering and taking into account "other factors" where there is involved a formal contract "reciting that a particular person is the employer and giving him the right of control" (p. 10). As a sole ground of defense of the decision below, the government now, nevertheless, contends that where such formal contract exists the Commissioner has the right to choose to treat the contract as conclusively establishing the fact as to which contracting party is the employer and that, right or wrong, such determination is not subject to court review. To that contention this division of brief will be addressed.

The government brief in the court below contained a profound statement of the basic premise or starting point for analysis of the question at hand. That brief said:

> "The substantive provisions of our revenue laws are drawn so that a tax is imposed depending upon the existence or non-existence of *specified facts*. Here the crucial fact is the *employment relationship*, which in turn depends upon whether the right of control was reserved." * (Italics added)

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* Except for a sentence containing an argumentative assertion that administration of the Act would be "hampered" if the ascertainment of the coverage "must always abide judicial determinations on the basis of individual factual situations" and a brief reference to *Higgins v. Smith*, 308 U. S. 473, as holding that the government may acquiesce in a fiction if it serves the interests of the government to do so, the government's brief below was devoted entirely to argument that the District Court erred in its factual determination.

As the distinguished then Assistant Attorney General, Samuel O. Clark, Jr., so aptly said, liability of the petitioners for the social security taxes on the orchestra members' wages depends upon the existence or non-existence of the employment relationship, an ultimate *fact* the existence of which means liability and the non-existence of which means non-liability.

Although the government now virtually admits that the Commissioner erred in determining that an employment relationship existed between Petitioners and the orchestra members, the government nevertheless contends that the *Commissioner's* admittedly erroneous *determination* operates to conclusively establish the fact and to fix and fasten tax liability upon Petitioners.* The proposition thus advanced violates every fundamental principle of sound administrative law and is utterly incongruous and inconsistent with the plan and framework of the Revenue laws which grant stringent tax collection remedies to the Commissioner of Internal Revenue, and, in turn, assure to every taxpayer a day in court to contest the validity of each tax exaction. Analysis of the Revenue laws and of the consequences of adoption of the rule contended for by respondent will readily demonstrate that this is true.

This court has long recognized the Internal Revenue laws as providing a magnificent "system of corrective justice" providing two alternative routes for redress of any taxpayer's grievance on account of a wrongful tax exaction, each of the alternative routes being intended to operate independently and to afford complete relief. *State Railroad Tax Cases*, 92 U. S. 575, 613; *Dodge v. Osborn*, 240 U. S. 118.

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* Even though it be denied that the government's brief amounts to an admission of the Commissioner's fact finding error, it is obvious that the contention under discussion is properly analyzed and tested by assuming such concession.

The taxpayer's appellate remedy through the Board of Tax Appeals—now Tax Court—envisages a review of the Commissioner's decisions by a special tax tribunal vested with plenary and effective powers. *Old Colony Trust Company v. Commissioner*, 279 U. S. 716. It is a well established rule of that tribunal that the fact decisions and rulings of the Commissioner have no greater weight or effect than to give rise to a rebuttable presumption of correctness. *Big Wolf Corp. v. Commissioner*, 2 T. C. 751 (Acq. 1943 C. B. 3); *Clara O. Beers*, 34 B. T. A. 754. This court has consistently refused to disturb decisions of the Board of Tax Appeals—Tax Court reversing the Commissioner *upon the premise and assumption* that his factual determinations are only prima facie correct and not conclusively binding. *Elmhurst Cemetery Co. v. Commissioner*, 300 U. S. 37; *Commissioner v. Scottish American Investment Company, Ltd.* 323 U. S. 119; *Wilmington Trust Company v. Helvering*, 316 U. S. 164.

Alternatively, there is made available to aggrieved taxpayers the procedure involving payment of the Commissioner's tax demands and then seeking redress for any wrongful exaction through court action for refund. The plan and theory behind this alternative remedy was succinctly described in *United States v. Jefferson Electric Manufacturing Company*, 291 U. S. 386, 395, 396 as follows:

> ". . . Anterior to collection the Commissioner possesses exclusive authority to revise, correct or reject assessments and the courts are forbidden to entertain suits 'to restrain the assessment or collection.' After collection aggrieved taxpayers are accorded a limited time within which to apply for refunds, and the Commissioner is authorized to grant the applications where the taxes are shown to have been erroneous or illegal; *but a denial by him is not final.* If the application is either denied or not acted on by the Commissioner the taxpayer is accorded a fixed period within which to bring suit for a refund against the United

States or the collector who received the tax, and if in the suit he establishes that the tax was erroneous or invalid, that it was paid by him, and that his claim has been duly and seasonably presented and prosecuted, he is entitled to judgment for a refund of the amount paid with interest." (Italics added)

Consistent with the guiding principle applicable in the Board of Tax Appeals—Tax Court tribunal, this court, in reviewing refund proceedings, has uniformly held that fact determinations of the Commissioner are properly treated and considered as only prima facie evidence of correctness and not as conclusive. *United States v. Rindskopf*, 105 U. S. 418; *Wickwire v. Reinecke*, 275 U. S. 101; *Williamsport Wire Rope Co. v. United States*, 277 U. S. 551; *Lucas v. Ox Fibre Brush Co.*, 281 U. S. 115; *Welch v. Helvering*, 290 U. S. 111; *United States v. Jefferson Electric Manufacturing Co.*, 291 U. S. 386. Typical statements of the rule applied in the refund cases are

Wickwire v. Reinecke, Supra:

"It is quite clear that . . . the ruling of the trial court was erroneous, and that the decision of the Commissioner of Internal Revenue was not conclusive, but only furnished prima facie evidence of its correctness."

Williamsport Wire Rope Co. v. United States, Supra:

"It is true that where the Commissioner's action is reviewable judicially, his findings of fact in making an assessment, as distinguished from his determinations involving administrative discretion, constitute only prima facie evidence; and that, in cases arising under the internal revenue laws, such findings are commonly reviewable by courts in appropriate proceedings in which the facts become an issue. *United States v. Rindskopf*, 105 U. S. 418, 422, *Wickwire v. Reinecke*, 275 U. S. 101."

United States v. Rindskopf, Supra:

"The assessment of the Commissioner of Internal Revenue was only prima facie evidence of the amount due as taxes upon the spirits distilled between the

dates mentioned. It established a *prima facie* case of liability against the distiller and nothing more. If not impeached, it was sufficient to justify a recovery; but *every material fact* upon which his liability was asserted was open to contestation."

The circuit courts and the Court of Claims uniformly apply the rule of the above quoted cases. *United States v. State Street Trust Co.*, (CCA 1st) 124 F 2d 948, 950, 951; *Van Norman Co. v. Welch*, (CCA. 1st) 141 F 2d 99, 104; *Wilson v. Eisner*, (CCA 2nd) 282 F 38, 42; *United States Trust Co. of N. Y. v. Anderson*, (CCA 2nd) 65 F 2d 575, Cert. Den. 290 U. S. 683; *Pittsburgh Hotels Co. v. Commissioner*, (CCA 3rd) 43 F 2d 345, 347; *Lunsford v. Commissioner*, (CCA 6th) 62 F 2d 740, 742; *Jones v. Commissioner*, (CCA 7th) 38 F 2d 550; *Spillson v. Smith*, (CCA 7th) 147 F 2d 727; *E. Albrecht & Son v. Landy*, (CCA 8th) 114 F 2d 202, 206; *Anglim v. Acme Brewing Co.*, (CCA 9th) 143 F 2d 412, 415. Cert. Den. 323 U. S. 765; *Motter v. Patterson*, (CCA 10th) 68 F 2d 252, 253; *Betts v. United States*, 62 Ct. Cl. 1; *Meyer v. United States*, 60 Ct. Cl. 474.

In this very case the Commissioner is insisting upon preservation of *his* right to consider and take into account evidential factors other than the parties' contract in determining the existence or non-existence of an employment relationship. (Resp. Brief p. 15-17). The Treasury Department's own regulations and rulings in effect at the moment when his factual determinations in the cases at bar were made, as well as all other authorities, clearly establish the law to be that at least nine evidentiary factors all are pertinent to and shed light on the question of existence or non-existence of employment relationship.* The Commissioner is here claiming finality for a factual decision which was admittedly made without consideration

* Authorities referred to are set forth in petitioners' brief at pages 20 to 38.

of any of the pertinent evidence except that supplied by the Form B contract. The government's brief admits that the Commissioner's ruling and decision which unalterably fixed his position in the cases at bar were rendered long before the orchestra engagements here involved were arranged for or played and were based entirely and exclusively upon the provision of the Form B contract purporting to vest right of control in the ballroom establishments. (Resp. Brief, pp. 8, 9, 21) In this situation, to contend that the Commissioner may arbitrarily choose to consider and give weight to but one of the numerous pertinent evidential factors is the exact equivalent of asking this court to abandon and repudiate its uniform holdings limiting the effect of the Commissioner's decisions to prima facie evidence of correctness, and to undermine and remove the very cornerstone foundation of the "system of corrective justice" thus far prevailing in the Internal Revenue laws.

When a similar erroneous fact finding of the Commissioner was reviewed in *Lucas v. Ox Fibre Brush Co.*, 281 U. S. 115, the court, speaking through Chief Justice Hughes, said:

> "Being deductible as a reasonable payment there was no authority vested in the Commissioner to disregard the actual transaction and to readjust the income on another basis which did not respond to the facts."

The cases at bar present no unique or peculiar situation affecting the application of the general rule of nonfinality of the Commissioner's assessment and the factual determination upon which it was based. No claim has been made that the Commissioner's decision in question was made in exercise of any specific or special grant of administrative discretion. No provision of the Internal Revenue Laws or of the Social Security Act investing the Commissioner with any special discretionary power to re-

define or determine the fact as to existence of employer-employee relationship in such situation as exists in these cases is claimed to exist, and on examination of those statutes no express grant of such power to the Commissioner appears at any place.

The narrow confines of situations where the special powers of "administrative discretion" referred to in *Williamsport Wire Rope Co. v. United States*, supra, create an exception to the general rule as to reviewability of the Commissioner's fact determinations were made clear in *United States v. Jefferson Electric Manufacturing Co.*, 291 U. S. 386. In that case the government claimed finality for the Commissioner's decision rejecting a claim for refund because the statute in question (creating a right of refund of automobile accessory manufacturers' excise taxes) required the refund claimant to "establish to the satisfaction of the Commissioner" various facts, including the fact that the taxpayer had not passed on the tax at time of resale. On the question of the meaning and effect of that special provision of the act, the court said:

> "Only by inadmissible straining could it be held to invest the Commissioner with absolute authority or discretion with respect to such refunds."

In support of its position according finality to the Commissioner's fact decision, the Government-Respondent argues that because taxpayers "knowingly" executed the Form B contracts they "should not be able to require the government to disregard the obligation . . . undertaken" (p. 21) and should not "be in a position to insist that the Treasury disregard the contracts into which they have entered." (p. 19).* It is true that Petitioners signed the

* The *exact* legal theory of Respondent is left indefinite and uncertain by the government's brief. Neither estoppel, waiver, nor any other affirmative defense was ever plead or relied upon in the lower courts and therefore obviously could not be effectually asserted in this court.

Form B contracts and knew what the terms and provisions thereof were. No one doubts that there was thereby permitted to come into existence an item of evidence which, *if considered alone and apart from all other relevant facts and circumstances*, would warrant and justify the conclusion that Petitioners became and were employers.

If it be the duty of this Court to consider punitive measures, as the Government-Respondent's argument assumes, Petitioners must accept such punishment as fits the crime of having unwillingly* signed a contract which, as was expressly found by the trier of fact, "was not entered into by fair negotiation between the parties" and was not intended by either contracting party to accurately set forth their respective rights and responsibilities. (R. 663). But, if it be proper for this court to consider the question of what is proper punishment for the *unwilling* signers of the unreal fiction that is the Form B contract, what is appropriate to be done to the *other* contracting parties whose representatives devised, perpetrated and promulgated the misleading document and coerced *unwilling* Petitioners into signing?

The Commissioner would have this court accord him an *incontestable* "right to choose" to confer a tax immunity *reward* upon the party to the Form B contract who not only instigated, devised and promulgated that misleading and deceptive document but also coerced an *unwilling* other signatory party into signing. Thus, the situation presented in this very case is a striking example of the dangerous and frightening nature of the proposition contended for by Respondents.

Here, in ex parte hearings and conferences, the Commissioner was persuaded by representatives of Intervenor-Respondents to rule *in advance* that all orchestra engage-

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* At page 18, the government Respondent's brief concedes that the petitioners signed the contracts "unwillingly."

ments booked under the Form B contracts would result in tax liability of the ballroom establishments. (R. 575, 577, 578) It so happened that in this case, Intervenor-Respondents, through the power and influence of the American Federation of Musicians, were able to lawfully coerce *unwilling* Petitioners into becoming signatory parties to the Form B contract portraying an utterly unrealistic fiction. The Commissioner insists that, his approbation having been obtained, the ostensible arrangement purported to be created by the signatory parties is invulnerable to attack. It is self-evident that it is as likely to be labor as management which is in "the inferior bargaining position" * which the Petitioners happened to occupy in the instant cases. The rule which might conceivably momentarily please and bring flush of apparent victory to the spokesmen for a great and powerful labor union today could well become a frightful instrument of oppression and injustice in countless cases yet to arise.

The rule which the Respondents urge upon this court would transform the courts from their historic functions as a "haven of refuge for the weak and oppressed" to that of a potential accessory to oppression. It would confer upon the Commissioner the arbitrary power to assess and impose a tax upon whomsoever he and the contracting party who happens to possess superior bargaining power may together justly or *capriciously* decide.

Nor is the potion sought to be served rendered any more appetizing or less deadly because Respondent's brief gives abstract lip service to a disclaimer that "any general right to choose between possible taxpayers" is contended for. The substance and effect of the rule contended for is exactly that which is disclaimed. The Commissioner *did* choose between Petitioners and Intervenor-Respond-

* This is the government's own description of Petitioners' situation in the instant cases. See pp. 18-19, Government Brief

ents as to which should be taxed and which should be relieved of the burden of the tax in question. As taxpayers aggrieved by the Commissioner's choice, Petitioners, at their first and only opportunity to be heard, proved that the choice was made and the tax was exacted on account of an erroneous fact decision of the Commissioner. If the Commissioner's erroneous choice is permitted to stand, such decision can have no other meaning or effect than to invest the Commissioner with absolute and unqualified "right to choose between possible taxpayers." That such rule, if adopted and established by this court, would apply to and govern a horde of future determinations and decisions of the Commissioner is too clear for argument.

The cases cited by the Government-Respondents are not apposite. All of the cited cases, except one from outside the field of Internal Revenue laws (*Gray v. Powell*) involve the very narrow question of when the separate identity of a controlled corporation or a business trust will be recognized and made the basis for tax assessments and when it will be disregarded. The age old principle as to when the court shall look through the corporate entity was set forth in *New Colonial Ice Co. v. Helvering*, 292 U. S. 435, 442, as follows:

> "As a general rule a corporation and its stockholders are deemed separate entities and this is true in respect of tax problems. Of course the rule is subject to the qualification that the separate identity may be disregarded *in exceptional situations where it otherwise would present an obstacle to the due protection or enforcement of public or private rights.*" (Italics ours)

The quoted rule was applied and adhered to in the quoted case and in the *Higgins v. Smith*, 308 U. S. 473, *Moline Properties v. Commissioner*, 319 U. S. 436, cases cited by the government brief. The opinions in each of

those cases make crystal clear that the grounds and theory upon which the corporate entity was disregarded was that the taxpayers had created *fictitious* and *unreal* paper set-ups to avoid their just tax obligations. This principle finds expression in the court's opinions as follows:

> "The government may look at actualities and upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute. To hold otherwise would permit the schemes of taxpayers to supersede legislation in the determination of the time and manner of taxation. It is command of income and its benefits which marks the real owner of property."
>
> *Higgins v. Smith*, 308 U. S. 473, 477, 478.

> "In general, in matters relating to the revenue, the corporate form may be disregarded where it is a sham or unreal. In such situations the form is a bald and mischievous fiction."
>
> *Moline Properties v. Commissioner*, 319 U. S. 436, 439.

And the meaning and effect of the holdings in the above quoted cases was summarized in *Schenley Distillers Corp. v. United States*, 326 U. S. 432, 437 as that ". . . corporate entities may be disregarded where they are made the implement for avoiding a clear legislative purpose."

Before and during the interval when the doctrine of the above mentioned cases was evolving and becoming established as a settled rule of law, there came before the court a number of cases involving the situation where a corporation wholly owned by a single stockholder was caused to be validly created and to function and operate as a corporation; and tax assessments predicated upon recognition of the separate legal identity of such corporations were resisted on the ground that the corporation, being solely owned, was a mere fiction which should be dis-

regarded. In each of these cases the court looked into the question of whether or not the corporation was validly created and functioning and, those facts being found to exist, the assessments were uniformly sustained. *Burnet v. Commonwealth Improv. Co.*, 287 U. S. 415; *New Colonial Ice Co. v. Helvering*, 292 U. S. 435, 441; *Moline Properties v. Commissioner*, 319 U. S. 436.

Whenever and as often as the rule of the *Higgins v. Smith* case was invoked, it was contended that the rule was inconsistent with that of the *Commonwealth Improv. Co.* case requiring the taxpayers to accept the tax burdens which the Revenue Laws imposed on account of the existence of the corporate entities which they created and employed to further their business purposes. Naturally, in distinguishing those cases, the court referred to the taxpayer's "choice of the advantages of incorporation to do business" and his "having elected to do business as a corporation" in its statement of the reasons why the assessments in question were proper and lawful. This language was appropriate because *corporations* cannot come into existence unless the incorporators and stockholders elect to create an artificial or fictitious person and, since the applicable Revenue Laws imposed taxes in recognition of the separate identity of the stockholders, the assessments in question constituted a proper application of the law to the determinative facts.

The cases involving corporate entities cited by the government are utterly devoid of language supporting any such conclusion as that "the right to make the choice . . . is the Commissioner's." The statement in *Higgins v. Smith*, 308 U. S. 473, 477, that "the government may look at actualities and *upon determination that the form employed* for doing business or carrying out the challenged tax event *is unreal or a sham* may sustain or disregard the effect of the fiction *as best serves the purpose of the tax*

statute" obviously was not intended to imply any special quality of finality or conclusiveness to the Commissioner's fact determinations. The other cited authorities are even wider off the mark.*

Only one of the cited authorities for what might properly be called the "Commissioner's incontestable right of choice" theory of the Government-Respondent involves any question other than that of recognition or non-recognition of corporate entities or business associations. The decision in that case (*Gray v. Powell*, 314 U. S. 402) makes very clear that the case involved an administrative body's fact finding with respect to "a matter left specifically by Congress to the determination of an administrative body" and this court held that there having been "a fair hearing, with notice and an opportunity to present the circumstances and arguments to the decisive body, and an application of the statute in a just and reasoned manner" *the exercise of the special power* vested by Congress in the administrative body should not be disturbed. The holding of that case comes squarely within the well recognized

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* *Interstate Transit Lines v. Commissioner*, 319 U. S. 590, cited in the Government-Respondent brief, comes no nearer to the question under discussion than to raise the question whether, under the doctrine of the *Moline Properties* and the *Higgins v. Smith* cases, the separate corporate entity of a subsidiary corporation could be disregarded.

Edwards v. Chile Copper Co., 270 U. S. 452, 456 merely holds that a subsidiary corporation taxpayer involved in that case was engaged in business within the meaning of that term employed in a taxing statute. The opinion contains neither holding nor language throwing light on any question of the weight and effect to be given to the Commissioner's decision to levy a tax on the taxpayer.

Schenley Distillers Corp. v. United States, 326 U. S. 432, states the rule as to non-recognition of corporate entities to be that "while corporate entities may be disregarded where they are made the implement for avoiding a clear legislative purpose, they will not be disregarded where those in control have deliberately adopted the corporate form in order to secure its advantages and where no violence to the legislative purpose is done by treating the corporate entity as a separate legal person." The language of the opinion stating that the creator of the corporation "does not have the choice of disregarding the corporate entity in order to avoid the obligations which the statute lays upon it for the protection of the public" must be considered in the light of the holding of the court, *after reviewing all of the pertinent facts*, that the subsidiary corporation contracting with its parent and other subsidiaries was a "contract carrier."

exception to the general rule of non-finality of an administrative officer's decision where the decision is a "determination involving administrative discretion" such as Justice Brandeis referred to in his masterly statement of the rule in *Williamsport Wire Rope Co. v. United States.* (See p. 8 hereof). If further grounds for distinguishing the *Gray v. Powell* case are necessary, elements entirely lacking in the cases at bar affirmatively appear in that case as follows:

(1) The party sought to be charged was accorded a fair hearing and opportunity to present the facts to a quasi judicial tribunal.

(2) The party sought to be charged was "the creator of the plan" which was held to spell out liability.

(3) The case involved no question of administration of Revenue laws by the Commissioner of Internal Revenue in a manner consistent with and under the "system of corrective justice" provided by the Internal Revenue Laws of the United States.

In *Helvering v. Coleman-Gilbert Associates,* 296 U. S. 369, cited by the government, the court upheld findings of the Commissioner to the effect that a certain business trust was a business association taxable as a corporation. No finality or incontestability with respect to the Commissioner's original finding was either contended for or held by the court to exist. The Commissioner was upheld on the ground that his decision was *right* and not on the ground that the Commissioner's determination was incontestable. The entire text of the court's opinion shows a patient analysis by the court applying the applicable Revenue Law to the established facts. Read alone and apart from the remainder of the opinion, the excerpt quoted in the government's brief does not fairly reflect either the holding of the court or the thought intended to be expressed by the author of the opinion. The quoted

excerpt was nothing more nor less than forceful statement of a reason why a trier of fact might justifiably attach particular weight to the formal Trust Agreement willingly entered into by all interested parties.

Petitioners submit that, considered together with the entire context of the opinions in which they appear, the single sentence statements of this court quoted in the government's argument do not say and were not meant to imply that the Commissioner ever possesses an "incontestable right to choose" to treat any single evidential fact as conclusive of an ultimate fact required to be found as the basis for a lawful assessment where other and more weighty evidential facts require a contrary finding on the determinative ultimate fact. That this is even true when intricate questions of recognition or non-recognition of corporate entities are involved is clearly established by *Helvering v. Tex-Penn Co.*, 300 U. S. 481. In that case the Commissioner assessed income tax against the taxpayer as a result of his fact finding that the taxpayer received $350,000 cash, in addition to stock, in a corporation merger, the applicable section of the Internal Revenue Laws being to the effect that unless the sole consideration received was stock the transaction was a taxable transaction. The Commissioner's determination that $350,000 cash (in addition to stock) was received by the taxpayer was based upon the formal contract of the parties which, *on its face, clearly and unambiguously* stated the consideration for the transfer to be $350,000 and a stated number of shares of stock, and a formal resolution of the Board of Directors authorizing the contract and containing the same language reciting the consideration to be received. On the taxpayer's appeal, the evidence before the Board of Tax Appeals proved that, notwithstanding the contrary recitals in the formal contract sighed by the taxpayer and in the Board resolution, the parties to the contract did not

actually intend to pass anything other than stock as consideration and that in fact no cash did change hands as consideration for the property transferred by the taxpayer. The decision of the Board of Tax Appeals affirmed the Commissioner and, on appeal from a Circuit Court reversal of the Board, this court affirmed, saying:

> "In form the documents upon which the Board of Tax Appeals relied stated that the $350,000 was corporate consideration passing from Transcontinental, but in fact, it was not, and the rule is well established that in determining tax liability, taxing authorities *must* look through form to fact and substance. * * *
>
> "The validity of the ultimate finding * * * is to be tested by what is in fact done rather than by the mere form of words used in the writing employed. * * *
>
> "As against the board's findings showing what was actually done in consummation of the transaction, no weight as evidence can be given to mere recitals, directions, engagements and admissions of respondents contained in the documents relied on by the board. It should have held that the Transcontinental Stock was the sole consideration for the transfer of the Tex-Penn assets. The Circuit Court of Appeals rightly held that the ruling to the contrary was erroneous." (Italics ours)

Progressively, as the true import and meaning of the government's "incontestable right of choice" theory is thought over and analyzed, any thoughtful student will come to recognize that the short paragraph in the dissenting opinion of Judge Gardner below (R. 708) dealing with the question under discussion was masterly and profoundly wise. Petitioners respectfully submit it as a perfect summation of the principles sought to be made clear in this division of brief.

> "What Congress has commanded to be taxed must be taxed. Here the statute taxes employment and

nothing else. Both the Commissioner and the taxpayer are subject to the statute and can not by adopting a fiction of the parties shift the burden of tax from those upon whom Congress has placed it.".

II.

REPLY TO INTERVENERS' BRIEF.

A.

Correction of erroneous assumptions of interveners as to the issue presented and as to certain facts.

1.

The basic question in these cases is not whether the leaders could become the employees of the petitioners but whether under all of the facts of this record the leaders were the employees of petitioners.

Interveners seek to inject a pseudo issue into petitioners' controversy with the government by stating:

> "The basic question in this case is whether interveners could contract to perform their services as the employees of petitioner or whether they, as against their will, were required by law to perform their services only as independent contractors." (P. 4, Interv. Brief)

> "This poses the fundamental question involved in this case, namely, may a person require as a condition employment that he occupy the status of an employee of the one for whom he is to perform services, or is a person required to perform work for another only in the capacity of an independent contractor even though he expressly refuses to work in any other capacity than that of an employee?" (P. 17, Interv. Brief)

The foregoing statements are incorrect statements of the real issue in these cases because each assumes, contrary to the findings of the trial court and the undisputed record supporting such findings, that the leaders were unwilling to perform their engagements as independent contractors but intended that such performance was to be solely in the capacity of an employee. The trial court in its third finding (R. 663) expressly found that the parties at the time of the execution of the Form B contracts did not thereby intend to transfer the right of control over the members of the orchestras and the method and manner of doing the work from the leaders to the ballroom operators. The trial court in its first finding further found the leaders "exercised entire direction and control, and the right of control over their orchestras and the members thereof, and the method and manner of doing the work", and that each leader "exercised and had the exclusive right to hire and fire such members, to contract for and pay their wages, and to keep all profits and sustain and pay such losses as occurred from the performances." The court also found that "Such leader organized, managed and controlled such orchestra as an independent organization for hire and the true relationship as shown by the evidence was that such leaders were independent contractors and the members of the orchestras their employees within the meaning of the Internal Revenue Statutes." (R. 662, 663)

Aside from the question of contestability of the Commissioner's original fact determination, the real question before this court is the same one that was before the Circuit Court, namely, was there substantial evidence to sustain the findings of the trial court. This being true, all of interveners' argument as to whether the leaders can be required to perform their engagements as inde-

pendent contractors against their will is wholly beside the point.

Petitioners, having devoted a substantial portion of their main brief (pp. 48 to 84) to a detailed review of the abundant evidence supporting the above mentioned findings of the district court, will not repeat that evidence here. It is adequately summarized by Circuit Judge Gardner in his dissenting opinion (R. 707, 708) as follows:

> "The evidence is clear and convincing that the leaders exercised complete control of the means and manner of performance. They and they alone had the right to hire and fire; they and they alone determined the wages of the sidemen; and they and they alone actually paid the sidemen. The leaders were conducting an enterprise for profit, building up a name and reputation for themselves and their orchestras. The findings of the trial court that the leaders were in fact the employers is sustained not only by substantial evidence but by convincing proof. In fact a finding that the contract correctly reflected the relationship of the parties would, I think find no support in the evidence."

With commendable candor the government brief comments on this evidence in the following language:

> "The leader hired and fired the other musicians (known as 'sidemen') and determined their compensation, which was never less, but might be more, than the Union scale. (R. 136, 358) The leader paid the sidemen out of the sum received for the engagement from the petitioners and other ballroom operators. The leaders also paid transportation, agents' commissions, and other expenses out of this sum. (R. 135-136, 167-168) Any excess remaining was retained by the leader as profit; if there was a deficit the loss was borne by the leader (R. 137-138, 168)." (Govt. brief pp. 3, 4)

It is submitted that the leaders' retention of three of the most important attributes of an employer, namely, the right to hire and fire the men working under them, the

right to determine and pay their wages, and the right as entrepreneurs to reap a profit or incur a loss from their performance, shows beyond question that the leaders were entirely willing to perform their engagements as independent contractors and not as employees of the ballroom owners. Interveners' statements that the leaders were unwilling to work and refused to work in any other capacity than that of an employee is not only entirely without support in the record but it is directly contrary to the record.

Interveners' contentions that the leaders did not have the right to determine, fix and pay the wages of the sidemen in their orchestras because the leaders were merely conduits or agents for the ballroom owners for the distribution of such wages is flatly contradicted by the undisputed testimony of the leaders and ballroom owners alike that the leaders fixed and determined the wages of the sidemen and the method of payment. (Al Menke R. 136-139, 158; Paul Moorhead R. 168; "Doc" Lawson R. 272, 278; Pltfs' Ex. B-30, R. 279; Griff Williams R. 360, 361, 367, 390, 391, 394, 630, 631; Bartels R. 65, 66, 98; Geer R. 324 and 326)

Even the leaders' signing of the Form B contract can not be considered evidence of their unwillingness to perform engagements except as employees of the ballroom owners because, as pointed out in petitioners' brief (pp. 92 to 95) the control granted by that contract related solely to matters pertaining to results to be accomplished and not to the details of the work to be performed, and the further fact that under still other provisions of the contract the leader is empowered to select the members of the orchestra and fix and determine their compensation.

In this same connection the court's attention is again directed to the numerous by-laws of the American Federation of Musicians made a part of the Form B contract.

These by-laws (reviewed pp. 74 and 75 of petitioners' brief) not only recognize the leader as possessing all the characteristic indicia of an employer but expressly prohibit the existence of an employment relationship between an establishment owner and the sidemen of the orchestra. The government concedes (p. 8 of brief) that "many of these laws clearly indicated that the members were to be employed only by leader-members and not by outsiders." If, as Interveners' counsel contends, the musicians throughout the country collectively, through their union "decided to give up all the advantages they might obtain by performing as independent contractors" (p. 18 of brief), why was it that this same union at its annual convention in June of 1941 and again at its annual convention in June of 1942 *re-enacted* all of these by-laws recognizing the leader as the employer of the sidemen (See pp. 81 and 82 of petitioners' brief) and, at the 1942 convention, the Union even added a new by-law expressly referring to the leader as "promoting his business", "borrowing money" and "owning bands?" (Interveners' Ex. 6, R. 601, 602, 592) Such conceptions as to a leader are utterly inconsistent with interveners' claim that the leaders, following the promulgation of the Form B contract, were unwilling to function as independent contractors.

2.

The record facts abundantly sustain the trial court's finding that the parties to the Form B contract never intended that it would operate to transfer right of control from the leaders to petitioners.

After referring to provisions of the Form B contract denominating the relationship between the ballroom owner and the orchestra members as that of employer and employee, interveners on page 16 of their brief state:

"That petitioner fully understood the implications of these provisions in the contracts prior to executing the contracts and that he understood that these provisions of the contract gave him the right to control the musicians in the rendition of their services and placed him in the status of an employer in his employment relationship with the musicians, is clear from his testimony, for he stated that he objected to employing the members of the orchestra severally (R. 109), he objected to being designated the employer (R. 109), he objected to having the full right of control over the members of the orchestra (R. 110) and he knew that the contract placed him in the status of an employer. (R. 120)"

So that the court will have no misunderstanding as to what Bartels was objecting, we quote from his cross examination:

Q. Mr. Bartels, at the outset of your direct examination, you said you protested this contract when it was submitted to you?

A. That is right.

Q. Did you use the word object to it?

A. That is right. (R. 108, 109)

* * * * * * *

Q. Now you read on further, I presume that they agreed to render collectively to the employer services as musicians in the orchestra under the leadership of Griff Williams. Did you object to that?

A. I objected to it. Read the whole clause, it is not fair to take—

Q. I will read the whole paragraph. It says here: "That the employer employs the personal services of the employees as musicians severally, and the employees through their representatives agree to render collectively to the employer services as musicians in the orchestra under the leadership of Griff Williams to only the terms and conditions."

A. I objected to the word "employer" in that contract. (R. 109)

Q. And you objected to the word "severally," that you were employing these men severally, is that right?

A. Well, you mean individually when you talk severally?

Q. Yes, that's right.

A. I—yes, I objected to that.

. . . . . .

Q. Now did you object to the part of the contract which says "The employer shall at all times have complete control of the services of each of the employees which render to the satisfaction—

A. I did want it—Pardon me. I deny always that I am the employer of those musicians. Mr. Williams brought his orchestra there. He hired those men.

Q. But you saw that in the contract.

A. Yes.

Q. And you objected to that?

A. Yes, sir. (R. 110)

The further testimony of Bartels clearly shows that his mind was put at ease as to those objections by the assurances then and there given to him by the leader's booking agent's representative, Mr. Breyley. Bartels' testimony in this regard was as follows:

> "I objected to the signing of this where they call me the employer, and Breyley says, 'Go ahead and sign it,' he said, 'it is just a change that has been requested by Petrillo, and', he says, 'it will give you no more power now than it was before.' He said, 'It won't change your status a bit.'" (R. 116)

Interveners claim that Breyley's statements are immaterial because he had no authority to vary the Form B contract. (p. 45 of brief) In making the statements in question Breyley was not varying the contract but merely inducing a state of mind in Bartels by giving his

opinion or interpretation as to its effect. In this connection it should be borne in mind that Bartels, at another point in the record, testified that Breyley told him that Petrillo, as President of the American Federation of Musicians, had demanded the new contract and that the rules of the American Federation of Musicians be made a part thereof. (R. 119) Bartels also testified that he knew that these rules "say the orchestra leader is the employer of the sidemen." (R. 120) Being uncertain as to what the Form B contract with its conflicting recitals really meant, he did what any normal person in his position would have done. He voiced objections to the booking agent who was negotiating the engagement and received assurances that the objectionable provisions were not intended to have any practical effect. Certainly he had every reason to rely upon Breyley's statements. This reliance was particularly justified and reasonable because he already knew that the by-laws of the American Federation of Musicians made the leader the employer of the orchestra members. (R. 119) The important fact of Bartels' reliance upon Breyley's apparently authoritative interpretation is made very clear by his cross examination testimony, as follows:

> Q. In other words, you didn't believe Mr. Breyley when he said it didn't make any difference and your status remained the same. Am I right about that?
>
> A. Yes, I took Jim's word for it.
>
> Q. Did you believe it did not change the status or did you believe that it did change the status?
>
> A. Oh, I didn't believe it did, no.
>
> Q. Well, did you believe it did not change the status, why did you object to it, if you believed that?
>
> A. Because I didn't want to be called the employer. (R. 121)

. . . . . .

Q. I want to know whether on June 25, 1941, when you signed the contract engaging the services of Paul Moorhead and his orchestra you understood that the terms of the contract were such that you assumed the obligations of an employer to the sidemen and the leader of your orchestra?

A. I never have. (R. 121)

Q. Answer the question.

A. No.

Q. You didn't believe that?

A. No.

* * * * * * * *

Q. Then you continued to sign contracts on July 7, 1941, on September 25, 1941, as well as July 12, 1941 and November 6, 1941, each with the same clause, is that correct?

A. Well, I think they are different contracts. I signed them, yes, I signed them.

Q. You signed them all?

A. But not as employer. I signed them because they insisted, I signed them but I denied I was the employer. (R. 122)

Petitioners submit that the foregoing record testimony of Bartels wholly refutes interveners' contention that Bartels "understood that the provisions of the contract gave him the right to control the musicians in the rendition of their services and placed him in the status of an employer in his employment relationship with the musicians." On the contrary this record testimony constitutes substantial evidence along with the other evidence set out on pages 89 to 92 of petitioners' brief, supporting the district court's third finding that "at the time of the execution of the contracts, Form B, the ballroom operators never intended thereby to have transferred to them or to receive or exercise the control of or the right to control the orchestra

or any of the sidemen, or the method or manner of doing its or their work in any particular." (R. 663) There being substantial evidence to support this finding, the Circuit Court of Appeals was without the power to make a contrary finding. (R. 691) *McCaughn v. Real Estate Land, Title & T. Co.*, 297 U. S. 606, 56 S. Ct. 604, 80 L. Ed. 879, and *United States v. Jefferson Electric Mfg. Co.*, 291 U. S. 386, 54 S. Ct. 443, 78 L. Ed. 859.

B.

The rule that a written contract is not conclusive in determining the relationship of the parties is not confined to cases where the contract does not expressly vest the right of control in one of the parties.

Interveners assert (p. 19 of brief) that "the authorities cited by petitioners are concerned only with the factors that should be taken into consideration in determining who has the right of control over the services to be performed under a particular contract of hire, which does not expressly vest the right of control in either of the parties." They further assert (p. 22 of brief) that "where the agreement of the parties is definite concerning the question of the right of control, it is conclusive in determining the employment status of the parties."

At this threshold, Petitioners respectfully remind the Court that it is the Government that will live and work with the rule of law as to conclusiveness of such contracts as the Form B contract which is established through the decision of this case. The decision herein will likely govern and control in the administration of the social security acts for many years to come and its effects upon Interveners is as a drop of water in the ocean compared to its ultimate effects in the entire field of commerce and industry in which the rule here established will hereafter

be applied. In view of these circumstances, the Government's outspoken (even though it be belated) opposition to the rule contended for by Interveners as well as its clear-cut statements of reasons for taking that position should be accorded particular weight. For the convenience of the court we here set forth some of the pertinent statements of the Government on the question under discussion.

> "The court below * * * thought that the Form B contract shifted the right of control to the owners and *in and of itself* made them the employers. It is also suggested that in any event the Commissioner was not required to look through the contract at the instance of one of the parties to it. As will appear we are in accord with the second suggestion *but not as to the court's view of the conclusive nature of the contract.*" (Italics ours) (Government Brief p. 14)

> "We agree that significance attaches to the right of control and not merely to control actually exercised. But we do not regard that factor as all-conclusive when other factors point toward a different employer, particularly when it appears that actual control is in almost every important respect exercised by someone else.
>
> "If we assume, however, that the right to control alone need be considered and that the contract gives that right to the owner, we still would not treat the contract as decisive when evidence as to conduct shows that in fact the contract does not conform to the relationship actually existing. In this field, as in others, it is important that the parties not evade their obligations by the use of legal documents which on their face do, but in fact do not, change the substance of a relationship." (Government's Brief, p. 15)

> "We contend only that it (the contract) is not in and of itself decisive when all other evidence points in a contrary direction.
>
> "As we have pointed out, the Court below conceded this to be true as to recitals in a contract, but not as to promises or covenants, which in themselves estab-

> lish obligations * * * But to attribute absolute binding force to such covenants would still permit the circumvention of legislative enactments through mere skill in drafting legal papers which bear little or no relationship to the actual management of the affairs they purport to describe. If attorneys were advised that although declaratory or descriptive recitals were insufficient, agreements that a particular person had or had not the right of control would avail, they would find little difficulty in adapting their writings to the latter rule." (Government's Brief, pp. 16, 17)

Reference to the authorities readily reveals why the Government adopted the position set forth in the foregoing quotations. Not a single one of the many authorities cited by Petitioners (pp. 20 to 23 of brief) reciting and applying the general rule of inconclusiveness of the parties' contract hints or suggests in any way that the general rule is limited only to cases where the contract fails to specifically state the party in whom the right of control is vested. On the contrary the authorities referred to clearly indicate that just the reverse is true. For example, in both *Spillson v. Smith*, 147 F. 2d 727 (C.C.A. 7th) and *Anglim v. Empire Star Mines Co.*, 129 F. 2d 914 (C.C.A. 9th) the contract contained covenants purporting to create express obligations and yet the court, in each case, laid down the broad general rule in identical words as follows:

> "The law is well established that the employer-employee relationship is to be judged by the presence or absence of no single evidentiary factor but by an over-all view."

Interveners' contention as to the limited scope of the rule in question is squarely refuted by the holding of the Fourth Circuit Court of Appeals in *Gulf Refining Co. v. Brown*, 93 F. 2d 870, where the contract specifically provided that the "consignee should have entire charge of the management and operation of the business," which pro-

vision is certainly the equivalent of a clause expressly vesting the right of control in another. The court, however, applied what is referred to as "the non-exclusive tests" of an employment relationship as set out in Section 220 (2) of the Restatement of the Law of Agency. This decision furnishes striking proof of the error of the assertion made by interveners' counsel (p. 21 of brief) that this section of the Agency Restatement applies only to contracts in which "the extent of control" is not clearly indicated and thus is in dispute. The language of the section plainly shows that there is no justification whatever for ascribing any such limitation to the agency restatement rule.

Interveners' contention is also refuted by *Wabash R. R. Co. v. Finnegan*, 67 F. Supp. 94 (E.D. Mo.), wherein three contracts expressly provided that the contractor should supervise and exert authority over the workmen in the performance of the services. The court nevertheless held that these contracts were not conclusive and did not preclude consideration of such factors as the method of payment, who actually supervised the work, who furnished the tools and whether the contractor was engaged in an independent business. These are some of the very factors to which the district court gave consideration in the cases at bar. The Missouri district court in its opinion held that "such contracts can not serve to prevent fixing of the tax on the substance of the relationship, rather than the name the parties choose to give it", citing *Matcovich v. Anglim*, 9 Cir., 134 F. 2d 834.

In *Matcovich v. Anglim*, supra, *Willard Sugar Company v. Gentsch*, 59 F. Supp. 82 (N.D. Ohio) and *Royal Theatre Corporation v. United States*, 66 F. Supp. 301 (Kan.), the Courts found upon a consideration of all the facts that the right of control was in one of the parties notwithstanding an express recital in the contract denying that right

to such party. Nothing appears in the opinions in these cases which implies or suggests that the rule is any different in cases where the covenant respecting the right of control is an affirmative one. As the government brief points out (pp. 16 and 17), sound public policy requires that the rule be the same in both cases.

While it is true that the contract in *Williams v. United States*, 126 F. 2d 129 (C.C.A. 7th) did not contain a clause purporting to vest the right of control in one of the parties, the court did not in any way indicate that the five factors which it said (p. 132) had a material bearing on the right of control would lose their efficacy in a case involving such a contract. As petitioners pointed out in their main brief (p. 31), such factors are no less potent as affecting the right of control simply because the form of contract purports to place that right in one of the parties.

C.

The decisions holding that a contract is not conclusive of a relationship are not based on a finding that the parties by their conduct either abrogated or abandoned the contract or substituted a different agreement.

Interveners (pp. 23 to 25) seek to distinguish Petitioners' cases cited in support of the rule that a contract is not conclusive by claiming that in those cases the courts found that the parties either "abrogated" or "abandoned" the contract or "substituted a different agreement". An examination of the opinions in each of those cases reveals that those decisions were not based on any such grounds. On the contrary such examination shows that the courts considered that the contracts, as such, had not been abrogated, abandoned or rescinded by agreement.

For example, in *Commissioner v. Tower*, 327 U. S. 280, 66 S. Ct. 532, 90 L. Ed. Adv. Op. 559, one of the cases relied on by petitioners, the opinion made clear that the contract created a valid partnership under the laws of Michigan but proceeded to hold that the question of whether the parties intended a "genuine union for partnership business purposes" was still "a question of fact, to be determined from testimony disclosed by their agreement, considered as a whole, and by 'their conduct in the execution of its provisions.'"

Likewise, in *Doll v. Commissioner*, 149 F. 2d 239, another of the cases cited by petitioners, the Eighth Circuit Court of Appeals, after observing that "we have here a written instrument which is sufficient to create a partnership, both at common law and under Missouri decisions," stated:

> "The existence of such contract is not determinative of this tax issue. There remains the impact of the test of an analysis of 'all the circumstances attendant on its creation and operation.'"

The court's attention is also directed to the case of *Royal Theatre Corporation v. United States*, 66 Fed. Supp. 301 (Kan.) where the court did not find that the contracts defining one Fite's status as that of independent contractor were abrogated or abandoned or a new agreement substituted in their stead, but held that "'the declarations in the contracts that Fite was not an employee and that he was not to be controlled by the plaintiffs" were not of great probative value. The court then proceeded to consider the conduct of the parties both before and after the contracts and found that "Despite Fite's desire to claim, for tax purposes, the status of independent contractor, he was unwilling to assume the responsibilities of such status."

In the cases at bar the district court did consider the

conduct of the parties, not for the purpose of determining whether the Form B contract was subsequently abrogated or abandoned or a different agreement substituted in its stead, but for the purpose of determining whether the parties actually ever intended to create the genuine relationship of employer and employee between the ballroom owners and the orchestra members. In so doing, the trial court acted strictly in accord with the unanimous view of the authorities, and the Circuit Court of Appeals was clearly in error in holding that the trial court should have confined its inquiry to the Form B contract and the question of whether it was subsequently abrogated or abandoned by the parties.

D.

The so-called rulings of the commissioner on fragmentary facts and on account of ex parte conferences with interveners' representatives did not purge the Form B contract of its character as "an anticipatory arrangement" to escape taxes.

Interveners contend (pp. 48 to 52) that the Form B contract was not an anticipatory arrangement to escape taxation because of the blessing given it by certain rulings of the Commissioner of Internal Revenue. The record shows and the government now concedes (p. 21 of brief) that all the Treasury Department had before it when it made its rulings was the contract itself. As the government points out,

> "The Treasury did not have before it facts showing, and was not required to assume, that the changed status established in the contract would not be reflected in actual operations." (p. 21 of brief)

Since the record in the present cases establishes beyond question facts showing that the changed status ostensibly established by the Form B contract was not reflected in the actual operations of the parties, the rulings of the Commissioner mentioned by interveners can have no possible bearing as to whether the Form B contract was an anticipatory arrangement to enable the leader to escape taxation, which is what the trial court in his second finding (R. 663) found that it was.

At most, the so-called rulings of the Commissioner were merely letters expressing an opinion to the effect that the Form B contract appeared to be an efficacious arrangement to relieve the leader from the payment of social security taxes. *Langstaff v. Lucas*, 9 F. 2d 691 (W.D. Ky.) and *Bowers v. West Virginia Pulp & Paper Co.*, 297 F. 225 (C.C.A. 2d). There have been many cases where a Commissioner has approved a taxpayer's arrangement as making a transaction non-taxable and then later the same Commissioner or his successor has changed his mind and imposed the tax (just as the Commissioner twice changed his mind regarding the status of orchestra members performing engagements under contracts prior to the Form B contract). The courts have invariably held in such cases that the taxpayer was none the less liable, notwithstanding the Commissioner originally sanctioned the arrangement, *United States v. La Soviete Francaise De Bienfaisance Mutuelle*, 152 F. 2d 243 (C.C.A. 9th), certiorari denied, ... U. S. ..., 66 S. Ct. 820, 90 L. Ed. Adv. Ops. 731, *Sweets Co. v. Commissioner*, 40 F. 2d 436 (C.C.A. 2d), *Radiant Glass Co. v. Burnet*, 60 App. D.C. 351, 54 F. 2d 718, *Langstaff v. Lucas*, supra.

E.

The rule that a taxpayer may lawfully change his status to avoid taxation has no application to the present cases wherein the undisputed record shows the conduct of the parties, following the advent of the Form B contract, remained unchanged.

In reply to interveners' argument (pp. 52 and 53) that the rule announced by this court in *Gregory v. Helvering*, 293 U. S. 465, 55 S. Ct. 266, 79 L. Ed. 596, applies to the present cases, we need merely refer to the holding of this court in *Commissioner v. Tower*, 327 U. S. 280, 66 S. Ct. 532, 90 L. Ed. Adv. Op. 559, that such rule has no application to a situation where the conduct of the parties, following the adoption of the contract, remains unchanged from what it was before. This appears in the language of the opinion, as follows:

> "Respondent contends that the Tax Court's holding that he is taxable for the profits from the partnership is contrary to a principle long recognized by this Court that 'The legal right of a taxpayer to decrease the amount of what would otherwise be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.' *Gregory v. Helvering*, 293 U. S. 465, 469. We do not reject that principle. It would clearly apply, for example, in a situation where a member of a partnership, in order to keep from paying future taxes on partnership profits and in order to get into a lower income tax bracket sells his interest to a stranger, relinquishing all control of the business. But the situation is different where the taxpayer draws a paper purporting to sell his partnership interest even to a stranger, though actually he continues to control the business to the extent he had before the 'sale' and channels the income to his wife. Then a showing that the arrangement was made for the express purpose of reducing taxes simply lends further support to the inference that the husband still controls the income from his partnership interest, that

> no partnership really exists and that earnings are really his and are therefore taxable to him and not to his wife. The arrangement we are here considering was of the type where proof of a motive to reduce income taxes simply lent further strength to the inference drawn by the Tax Court that the wife was not really a partner. See Paul, Selected Studies in Federal Taxation, 2d series, pp. 293-300. To rule otherwise would mean ordering the Tax Court to shut its eyes to the realities of tax avoidance schemes."

The facts of the present cases bring them clearly within the above holding of this court. The undisputed evidence shows (R. 102, 139, 253, 277, 327, 364, 365) and the government now concedes (p. 9 of brief) that in actual practice the conduct of the parties was the same after the advent of the Form B contract as it was before. This being true, the showing in the present case that the contractual arrangement was made for the express purpose of relieving the leader from the responsibility for the payment of social security and employment taxes lends further support to the inference also amply sustained by other evidence that the leaders were still the employers of the sidemen of their orchestras notwithstanding the provisions of the Form B contract.

F.

The Form B contract itself expresses a primary intention that, in the event of a conflict between the by-laws of the American Federation of Musicians incorporated therein and its other provisions, the by-laws shall be controlling.

The Form B contract provided that "all the rules, laws and regulations of the American Federation of Musicians * * * are made a part of this contract." (R. 13) The government brief (p. 8) concedes that "Many of these laws

clearly indicated that the members were to be employed only by leader-members, and not by outsiders." Petitioners respectfully refer the court to pages 77 to 81 of brief for a fuller statement of the reasons why the letter of May 1, 1941, of James C. Petrillo, President of the American Federation of Musicians, did not constitute an implied repeal of these by-laws.

Interveners argue (p. 47 of brief) that these by-laws were not a part of the Form B contract because they conflict with its main purpose as revealed by the clause purporting to vest the right of control in the ballroom owners, and state:

> "It is a well settled rule of contract interpretation that a contract will be interpreted to carry out the intention of the parties and in the event of conflict in the provisions, the contract will be interpreted to carry out its main purpose."

We have no quarrel with the foregoing statement of the general rule of contract interpretation but we take issue with interveners' application of it to the present case. The intention of the contract to cause the by-laws to be paramount and controlling over any other provision is clearly and emphatically expressed in the provision that "the musicians performing services under this contract must be members of the American Federation of Musicians and *nothing in this contract shall ever be so construed as to interfere with any obligation which they may owe to the American Federation of Musicians.*" (Italics supplied). A construction of the contract which makes the sidemen the employees of the ballroom owners obviously interferes with their obligation under the by-laws to accept employment only from leader-members. Accordingly, the court should follow the contract's own mandate and resolve this conflict in favor of its by-law provisions.

It was exactly on this ground that the District Court

in *Spillson v. Smith*, (N.D. Ind.), C. C. H. Unemployment Ins. Service, Vol. 1, 9111, refused to give effect to provisions of a prior form of contract adopted by the musicians' union for the purpose of making the establishment owner the employer of the orchestra members. This clearly appears from the court's finding that:

> "But the tenor of those parts of the contract for that purpose are inconsistent with the clause therein binding the members of the Federation playing under said contract to all the obligations to the Federation of Musicians and the provision therein that 'nothing in this contract shall be so construed as to interfere' therewith."

The court then proceeded to hold that the effect of the Federation by-laws incorporated by reference into the contract was to make the orchestra leader, and not the establishment, the employer of the sidemen. The decisions of *Williams v. United States*, 126 F. 2nd 129 (C.C.A. 7th) and *Los Angeles Athletic Club v. United States*, 54 F. Supp. 702 (S.D., Cal.) are in accord with this holding.

G.

Interveners' contention that the parol evidence rule applies to the present cases is not sustained by the authorities.

Notwithstanding the holdings of both the district court (R. 662) and the Circuit Court (R. 690) that the parol evidence rule does not apply in an action involving a stranger to the contract, interveners nevertheless argue (pp. 54 to 56 of brief) to this court that such rule is applicable to the present cases. The case of *American Crystal Sugar Co. v. Nichols*, 124 F. 2nd 477 (C.C.A. 10th) cited by interveners on page 56 of their brief does not support their argument

but instead refutes it, as clearly appears from the court's statement in its opinion as follows:

> "The courts of Utah, in accordance with the great weight of authority, hold that the rule applies only in controversies between parties to the instrument and those claiming under them. *Here, the United States was a stranger to the contract. It asserts a tax liability, not a claim derived from either party to the contract, and it could not invoke the parol evidence rule.*" (Italics supplied)

Other authorities holding that the parol evidence rule does not apply in a controversy between one of the parties to a contract and the government are as follows:

Helvering v. Tex-Penn Oil Co., 300 U. S. 481, 57 S. Ct. 569, 81 L. Ed. 755.

Curran v. Commissioner, 49 F. 2d 129 (C.C.A. 8th).

Indianapolis Glove Co. v. United States, 96 F. 2nd 816 (C.C.A. 7th).

United States v. Title Guarantee & Trust Co., 133 F. 2d 990, (C.C.A. 6th).

H.

Independent contractors are not employees within the meaning of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

The District Court (R. 656) and the Circuit Court of Appeals (R. 685-687) each accepted the test set forth in the Treasury Department's regulations (Reg. 106, Sec. 402.204 and Reg. 107, Sec. 403.204) for determining who is an employee within the meaning of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act. These regulations expressly provide that in order for a person to be such an employee the relationship between him and the person for whom he performs services must

be the legal relationship of employer and employee and that "an individual performing services as an independent contractor is not as to such services an employee."

Interveners argue (pp. 58 to 64 of brief) that this court should reject the test which was provided in the Commissioner's Regulations and applied by both courts below, and hold that the term "employee" as used in the social security and federal unemployment tax acts includes independent contractors. The supporting argument is that the term "employee" should be interpreted in the light of what are claimed to be the broad social objectives of those enactments, similarly as the National Labor Relations Act was construed in *National Labor Relations Board v. Hearst Publications*, 322 U. S. 111, 64 S. Ct. 851, 88 L. Ed. 1170.

At the outset, we respectfully direct the Court's attention to government counsel's statement (p. 12 of brief) on this question as follows:

> "In the instant cases we do not get much help by referring to basic statutory objectives. For whoever is the employer * * * either the leader or the owner is the employer—the sidemen are accorded Social Security protection."

In support of their contention that the term "employee" as used in Social Security legislation should be so broadly construed as to fasten the tax liability upon Petitioners irrespective of whether or not the orchestra members were their employees, Interveners cite and quote from the report of the House Ways and Means Committee reporting the bill known as the 1939 Amendments to the Social Security Act stating the Committee's conclusion that the coverage of the act should not be confined to those encompassed in the common law concept of master and servant. The content of the original bill which occasioned the statement made in the quoted excerpt from the Committee report was the provisions of Amendments 97 and 98 which

sought to redefine the term "employee" and broaden the coverage of the act so as to include insurance salesmen and other persons held by the courts to be not covered by the act because not employees. The proposed amendments 97 and 98 were deleted from the bill before final passage and therefore the record is that the very proposal recommended by the Committee report quoted by Interveners' brief was rejected by Congress. (P. 14 Report No. 1461, 76th Congress, 1st Session) It thus appears that, with full knowledge and information of the fact that the Courts were uniformly confining the coverage of the act to employees as defined at common law, the Congress refused to broaden or change the coverage originally provided by the act.

The decision in the *Hearst Publications* case falls far short of warranting the levying of social security taxes on Petitioners in the cases at bar. The court's opinion in that case took special pains to make clear that persons who perform services for another *as entrepreneurs* are excluded from the purview of that decision, using the following language:

> "Congress had in mind a wider field than the narrow technical legal relation of 'master and servant,' as the common law had worked this out in all its variation, and at the same time *a narrower one than the entire area of rendering service to others.* The question comes down, therefore, to how much was included of the intermediate region between what is clearly and unequivocally 'employment,' by any appropriate test, *and what is clearly entrepreneurial enterprise and not employment.*" (Italics supplied)

That the leaders of the orchestras in the present cases were conducting an "entrepreneurial enterprise" is now conceded by the government by its statement (p. 13 of brief) that "the leaders of the name bands in the cases before the court certainly have the normal attributes of the en-

trepreneur." The court is respectfully referred to petitioners' main brief (p. 62) where it is pointed out that the leaders in the present cases possessed all of such attributes in that (1) their work required the exercise of independent judgment and professional skill; (2) each held himself out as available to the public generally; and (3) each stood to make a profit from the work of the men under him.*

Interveners' statement (p. 62 of brief) that they do not operate businesses is refuted by their own union's by-law expressly referring to a leader's right to borrow money "to promote his business." (Interveners' Ex. 6, R. 601, 602, 592) It is also refuted by the undisputed record evidence reviewed in detail on pages 61 to 70 of petitioners' brief showing that each of the leaders in the instant cases was engaged in an independent business for profit. (Interveners' Ex. 6, R. 601, 602, 592) And it is again refuted by the numerous court decisions cited on pages 86 and 87 of petitioners' brief ascribing to orchestra leaders the status of entrepreneurs. One of those decisions, *Williams v. United States*, 126 F. 2d 129 (C.C.A. 7th), is an express adjudication that Griff Williams, one of the interveners herein, was an enterpreneur engaged in an independent business for profit. (See p. 133 of 126 F. 2d)

Interveners' statement (p. 63 of brief) that the leaders "can not suffer a loss on any employment" is directly contrary to the testimony of the leaders themselves that whenever the receipts from an engagement were not sufficient to meet the salaries of their sidemen and the other expenses of the orchestra, the leaders stood the loss. (R. 138, 277, 362)

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* Interveners' statement (footnote p. 64 of brief) that Tiny Hill received but $15.00 for his engagement is incorrect. The record shows that in addition to this sum, Hill received $123.68 which he stated would be used to pay various expenses that may arise from time to time in the "operation of this enterprise" and that any excess amount at the end of the fiscal year would be charged to "Harry Hill's personal income and income tax made out accordingly." (Pltfs' Ex. A-1, R. 99, 100, 98)

Interveners' contention that independent contractors are employees within the meaning of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act is further answered by the following decisions of Circuit Courts of Appeal rendered since the decision of this court in the *Hearst* case: *United States v. Aberdeen Aerie No. 24*, 148 F. 2d, 655 (C.C.A. 9th); *McGowan v. Lazeroff*, 148 F. 2d 512 (C.C.A. 2nd); *Glenn v. Standard Oil Co.*, 148 F. 2nd 51 (C.C.A. 6th); *Spillson v. Smith*, 147 F. 2d 727 (C.C.A. 7th); *Greyvan Lines, Inc. v. Harrison*, 156 F. 2d 412 (C.C.A. 7th); and *United States v. Silk*, 155 F. 2d 356 (C.C.A. 10th). All of the foregoing decisions uniformly hold that independent contractors are not employees for social security and employment tax purposes.

The case of *United States v. Vogue*, 145 F. 2d 609 (C.C.A. 4th) and *Grace v. Magruder*, 80 U. S. App. D.C. 53, 148 F. 2d 679, cited by interveners (pp. 60 and 61 of brief) do not hold that an independent contractor is an employee for social security and employment tax purposes. In the *Grace* case, supra, which involved the status of coal hustlers, the court expressly stated (p. 681 of its opinion), "We conclude that these persons are not independent contractors." The *Vogue* case, supra, involved the status of "seamstresses" referred to by the court as "humble employees" to whom the law of independent contractor "was never intended to apply."

For the reasons above set forth petitioners respectfully submit that it persuasively appears that the tax levying statutes here involved are not intended to apply to or impose a tax upon the wages paid to any one other than an employee, and, the orchestra members not being employees of petitioner, the taxes in question were unlawfully exacted from them. Also, that even if the court should hold the Social Security Act to encompass a broader coverage than the common law concept of employee, the

taxes in question were nevertheless unlawfully exacted because the uncontradicted record facts conclusively prove that the leaders, as entrepreneurs, were the persons for whom the services here involved were rendered.

I.

The record evidence persuasively indicates that if the fictions of the Form B contract were to be considered determinative the task of administering the social security laws would be rendered more difficult rather than simplified.

The Government brief gives "faint praise" to Interveners' suggestion that acceptance of the Form B contract as determinative of the actual employment situation would simplify the administration of the Social Security Acts by saying that "the primary advantage to the Treasury in relying on the contract is its definiteness". (p. 22) This statement should be considered in conjunction with the statements in the Government's brief in opposition to the petition for certiorari as follows:

> "The Solicitor General authorized appeal to the Circuit Court of Appeals because the decision of an appellate court seemed advisable as to the effect of an industry-wide contract provision, and because in any event the intervening leaders in No. 731 intended to appeal." (p. 6)
>
> *"From an administrative standpoint there is no special advantage in collecting the tax from the establishments in which an orchestra plays one night stands rather than from the leader for whom the musicians work steadily."* (p. 7) (Italics ours)

The record in this case indicates some of the administrative difficulties which would result from adopting the fictions of the Form B contract as the basis for assessing

the tax. It shows that the revulsion of the leaders themselves to the unrealistic fictions set up by the Form B contract caused them to consistently misstate and understate to Petitioners the actual compensation paid to the sidemen. The leaders were commanded by Petrillo to specify on the back of the Form B contract the pay to be received by each sideman on the occasion of a single night engagement still days, weeks or months away at the time the contract is signed. In fairness to the leaders involved it should be borne in mind that the drafters of the Form B contract apparently were so engrossed in perfecting an "on paper" case that they did not realize how impossible it would be for the leaders to say in advance how much pay each musician would receive for a *single* night's work when the leader pays *weekly* salaries and usually doesn't know exactly how many nights in any week that his orchestra will play. Consequently, in those few instances when leaders such as Paul Moorhead and Al Menke did bother to furnish any listing of the sidemen and their pay, they protected themselves against trouble with the local union by filling in amounts exactly corresponding to the minimum local union rate (Pltfs' Ex. B-6 to B-24, R. 177 to 251, 176 and Pltfs' Ex. B, R. 147, 140, R. 325 and 161) and let it go at that. In each instance the amounts specified by the leaders were less than the actual pay and the actual rate of pay of the individual sidemen whom they listed. (Pltfs' Exs. B-6 to B-24, R. 177 to 251, 176, 258; Pltfs' Ex. B, R. 147, 140 and 136)

This record irrefutably reveals the Form B contract as such a monstrosity as to make it virtually impossible for the Treasury Department to perform its function of collecting the amount of tax intended to be collected and credited to the social security accounts of the hapless sidemen of traveling orchestras. This being the entire record of this case insofar as it sheds any light on the question

of the administrative problems resulting from the compulsory use of the Form B contract and the government's acceptance of it as determinative of the employer relationship question, there is certainly no reason to believe that the Form B contract is the answer to a Commissioner's prayer for an effortless and evasion proof tax collection instrumentality.

CONCLUSION.

It is respectfully submitted that the propositions and arguments asserted by Respondents, when fairly analyzed and carefully weighed, come far short of sustaining the decision of the court below. For the reasons urged in Petitioners' brief and this reply brief, the decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

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